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**Working Paper**

## Regional Comprehensive Economic Partnership: Reform Challenges and Key Tasks for the Philippines

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Philippine Institute for Development Studies  
*Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas*

## Regional Comprehensive Economic Partnership: Reform Challenges and Key Tasks for the Philippines

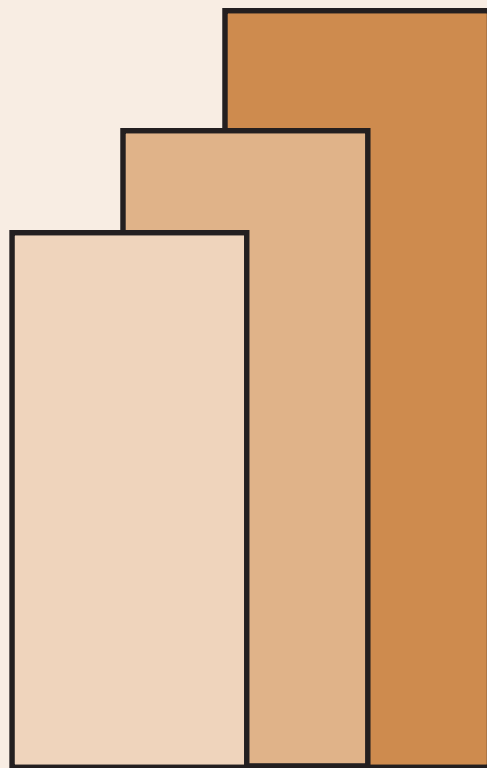
*Gilberto M. Llanto and Ma. Kristina P. Ortiz*

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# **Regional Comprehensive Economic Partnership: Reform Challenges and Key Tasks for the Philippines**

**Gilberto M. Llanto and Ma. Kristina P. Ortiz<sup>1</sup>**

## **Summary**

The ASEAN + 6 countries are currently engaged in negotiation for a Regional Comprehensive Economic Partnership (RCEP). If successfully negotiated RCEP will result into the world's biggest trading bloc, 40% of world trade, that offers significant benefits to participating countries. The first round of negotiations was held in Brunei in May 2013. The second round was recently held in Brisbane, Australia in September 2013. Negotiations are expected to conclude in 2015. The focus of the RCEP negotiations will be on the following eight key areas: trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement, and other issues. The paper discusses some of the challenges facing the Philippines during the difficult period of negotiation and the necessary structural and institutional reforms that it has to take to ensure that it will benefit from RCEP.

The paper calls the attention of policymakers to address critical constraints affecting the effective utilization of free trade agreements, growth, trade facilitation and customs administration, services liberalization, and investment incentives.

Key words: Asian free trade agreements, Regional Comprehensive Economic Partnership, rules of origin, utilization rate of FTAs, services liberalization, investment incentive packages, trade facilitation, customs administration

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## LIST OF ACRONYMS

AANZFTA	- ASEAN-Australia and New Zealand FTA
ACFTA	- ASEAN-China FTA
AKFTA	- ASEAN-Korea FTA
ASW	- ASEAN Single Window
ATIGA	- ASEAN Trade in Goods Agreement
CLMV	- Cambodia, Lao PDR, Burma, Vietnam
CEPEA	- Comprehensive Economic Partnership for East Asia
CGE	- computable general equilibrium
EAFTA	- East Asia Free Trade Area
FDI	- foreign direct investment
FTA	- free trade agreements
GDP	- gross domestic product
RCEP	- Regional Comprehensive Economic Partnership
ROO	- rules of origin
TPP	- Trans-Pacific Partnership
VASP	- Value Added Service Provider

## 1. Introduction

The ASEAN + 6 countries are currently engaged in negotiation for a Regional Comprehensive Economic Partnership (RCEP). If successfully negotiated RCEP will result into the world's biggest trading bloc, 40% of world trade, that offers significant benefits to participating countries. The trading bloc's estimated gross domestic product (GDP) is around US\$ 26.2 trillion (32% of the world's GDP) encompassing approximately 3.5 billion people or 48% of the world population (IMF 2012). The RCEP could become a powerful tool for enhancing regional economic cooperation and integration and more specifically for reducing the inefficiencies arising from a host of bilateral free trade agreements (FTAs) that have proliferated in the region.

In November 2012, the Leaders at the 21st ASEAN Summit in Phnom Penh, Cambodia made the decision to launch negotiations to conclude a Regional Comprehensive Economic Partnership across ASEAN+6 (the 10 ASEAN members plus Australia, China, Japan, South Korea, India, and New Zealand). The first round of negotiations was held in Brunei in May 2013. The second round was recently held in Brisbane, Australia in September 2013. Negotiations are expected to conclude in 2015.

This paper discusses some of the reform challenges facing the Philippines during the difficult period of negotiation and the necessary structural and institutional reforms that it has to take to ensure that it will benefit from RCEP. After a brief introduction, Section 2 provides an overview of existing FTAs in East Asia that leads to the discussion of the RCEP in Section 3. Section 4 reviews the key challenges facing the Philippines in the midst of on-going negotiations. The final section highlights the key reforms that Philippine policymakers should undertake to maximize the economic gains that could be derived from RCEP. A successful RCEP will significantly intensify trade and investment in the ASEAN and East Asia, and will provide a "framework within which business can use the region's resources to best effect in generating higher living standards and welfare for the region's people" (ERIA RIN 2012)<sup>2</sup>. In

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<sup>2</sup> "Regional Comprehensive Economic Partnership: A Statement by the ERIA Research Institute Network Meeting at Phnom Penh, October 2012; released on 22 November 2012

the run up to the envisaged ASEAN Economic Community, RCEP offers a powerful vehicle to strengthen economic cooperation through a robust increase trade and investment flows.

## 2. Overview on Current FTAs in Asia

Over the past few decades, Asia has been dubbed as the “global factory” as its economies developed through strategies that promoted trade liberalization, outward-oriented markets, physical infrastructure investment, and human capital development. This is evident in Asia’s trading trend as the volume rapidly increased from 14.9%<sup>3</sup> of total world merchandising trade in 1973 to 31.1%<sup>4</sup> in 2011. Such progress can be attributed to several factors: the economies’ move to identify and develop industries where they find comparative advantage and thrust towards a more liberalized economy, accompanied by sound financial policies (Kawai and Wignaraja 2013).

In the 1990s, the landscape of international trade started to evolve in response to trade liberalization schemes and later to the expansion of FTAs in the region. The importance of FTAs cannot be overemphasized especially now that the Doha Round has stalled due to a variety of disagreements among member nations (Beattle 2011). ASEAN countries and the more developed countries in East Asia are signatories to at least one of the many trade agreements that have proliferated in East Asia. The approach to greater trade and economic cooperation has shifted to bilateral FTAs from the multilateral approach under WTO. Apart from this issue, Kawai and Wignaraja (2013) pointed out three other factors that explain the rise of FTA initiatives, at least in Asia: (i) “deepening market-driven economic integration in Asia”, (ii) “European and North American economic integration”, and (iii) “the Asian financial crisis.” Asian countries are seemingly more inclined to engage in bilateral agreements than in multilateral ones as the former prove to be less complicated in terms of negotiation and agreement.

**Figure 1** shows that since early 2000, the number of FTAs in Asia has been rapidly increasing. To date, of the 257 FTAs that are currently at various stages of development (i.e.

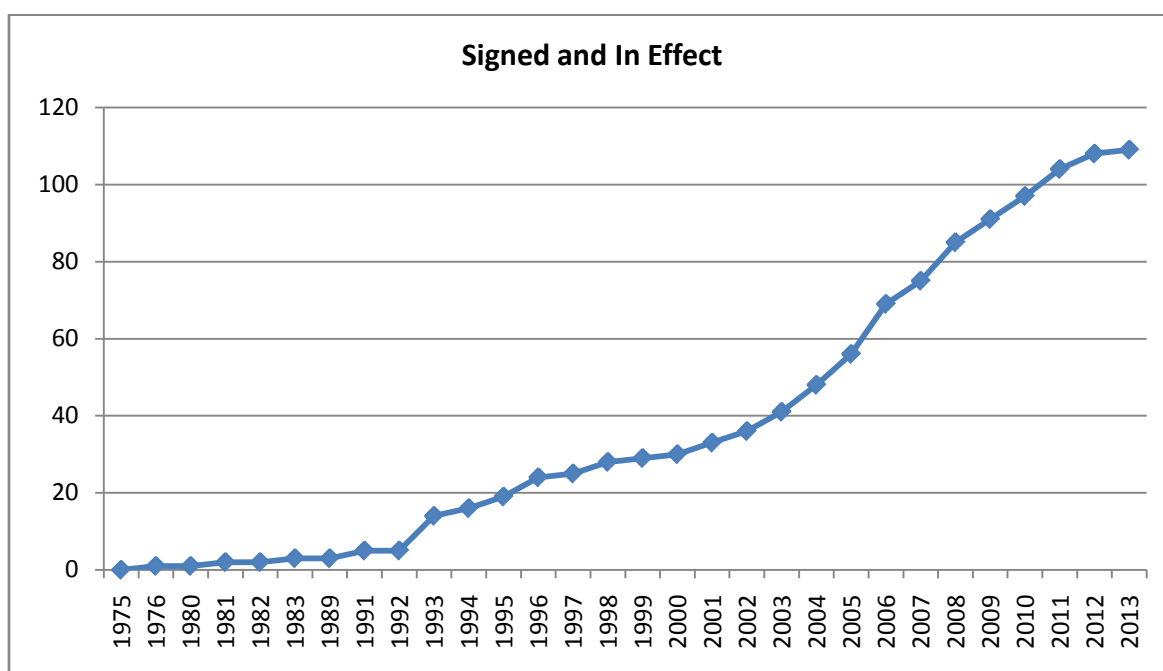
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<sup>3</sup> Includes China, Japan, India, Australia, and New Zealand. Source: <http://www.adbi.org/working-paper/2009/06/17/3025.restoring.asian.silk.route/asias.trade.flows.a.rising.trend/>

<sup>4</sup> Includes China, Japan, India, Singapore, ROK, Hong Kong, China, Australia.

proposed, under negotiation, signed and in effect), 189 are bilateral while only 68 are multilateral agreements (ADB 2013).

**Figure 1. Signed and In-Effect Foreign Trade Agreements (1975-January 2013)**



Source of raw data: ADB Asian Regional Integration Network;  
<http://aric.adb.org/fta-trends-by-status>

**Table 1** provides a list of bilateral and multilateral FTAs in the region and their current status. Aside from the Trans-Pacific Partnership (TPP), one of the most recent mega-bloc FTAs being proposed in the East Asia region is the RCEP, which is currently under negotiation and is expected to conclude in 2015 (ADB 2013).

It seems that the RCEP is a natural response to address the many challenges and difficulties that emanated from the so-called “noodle-bowl” effect brought about by convoluted provisions of several FTAs, i.e. ASEAN+1 FTAs (i.e. ASEAN-China, ASEAN-Japan, ASEAN-Korea, ASEAN-India, and ASEAN-Australia-New Zealand) and the desire to find a compromise agreement between the East Asia Free Trade Area (EAFTA/ASEAN+3) and Comprehensive Economic Partnership for East Asia (CEPEA/ASEAN+6) agreements.

Several studies have examined and estimated the impact of ASEAN++ FTAs on Asian economies, as well as to the rest of the world. Based on a computable general equilibrium (CGE) model used in Francois and Wignaraja (2008), Kawai and Wignaraja (2009) showed the income effects of the EAFTA and CEPEA on member countries up to 2017 baseline. Two of the key results of the study suggest that: (i) region-wide agreements in East Asia prove to be beneficial among the economies of the member countries in the presence of ASEAN+1 FTAs, and (ii) CEPEA (ASEAN+6) has higher income effects on member economies than EAFTA (ASEAN+3) (Kawai and Wignaraja 2009). More specifically, ASEAN members are expected to obtain the following projected gains (percent change in GDP by economy) under the CEPEA: Thailand (12.8%), Viet Nam (7.6%), Malaysia (6.3%), Singapore (5.4%), and below 3.0% for the other ASEAN members (Kawai and Wignaraja 2010). In terms of projected changes in output across sectors per economy, Francois and Wignaraja<sup>5</sup> (2008) showed that in general, the manufacturing and services sectors of the ASEAN members will most significantly benefit under the CEPEA scenario.

Despite the overall positive impacts of FTAs on Asian economies, the co-existence of several ASEAN+1 FTAs and many other agreements pose significant problems as they lead to the “noodle-bowl” phenomenon. The phenomenon describes a situation of intertwined and overlapping rules and regulations, i.e. (i) “varying modalities and timeframes for tariff concessions”, (ii) “different tariff preferences across products and FTAs”, and (iii) “varying rules of origin (ROOs) and administrative systems<sup>6</sup>” which will limit the benefits that could be gained from the FTAs and potentially decrease the private sector’s usage of preferential systems (Fukunaga and Isono 2013). Moreover, the “noodle-bowl” effect can impede the attainment of a strong and integrated regional market network, such as the ASEAN Economic Community by 2015 (Kawai and Wignaraja 2009).

Kawai and Wignaraja (2013) and other researchers, e.g., Medalla and Mantaring (2012) and Das (2013), have identified several challenges posed by various Asian FTAs. The first

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<sup>5</sup> The summary table, “CEPEA Scenario – Changes in Output across Broad Sectors Compared to 2017 Baseline (percent)” was prepared by Kawai, M. and G. Wignaraja (2010).

<sup>6</sup> Kawai, M. and G. Wignaraja [2009]



challenge is how to increase the utilization rate of FTA preferences. Several studies have observed the low utilization rates of FTAs in East Asia, which is considered as one of the most critical challenges of those trade agreements. The low utilization of FTA preferences can be attributed to the lack of information dissemination, especially among business firms, low margins of preference, high administrative costs and delays related to multiple rules of origin (ROOs), prevalence of non-tariff barriers, and exclusion list.

The second challenge is how to tackle the Asian “noodle bowl” effect brought about by the existence of multiple ROOs (Kawai and Wignaraja 2013), which increase transaction costs and discourage the participation of business firms, especially small and medium enterprises. Medalla and Rosellon (2012) observed that there are multiple FTAs with as many and non-uniform ROO systems and this situation compounds the set of rules that FTA users would need to hurdle, and customs administrations would have to implement. This observation seems to be contradicted by recent survey data compiled by Kawai and Wignaraja (2009). They reported that based on survey data, the Asian noodle-bowl phenomenon of overlapping FTAs did not have severe impacts on the six hundred nine (609) East Asian firms, wherein 155 were Philippine firms. More specifically, in the case of the Philippines, only 28% of the surveyed firms believed that multiple ROOs in the region would significantly add to the cost of doing business.

The above response of the surveyed Philippine firms does not seem to be plausible. Kawai and Wignaraja (2009) emphasized that the increasing number of FTAs in Asia would eventually become burdensome to business firms, especially to small and medium enterprises in view of their limited capacity to deal with such costs. Multiple and overlapping FTAs can subject the same commodity to different tariffs, tariff reduction timelines and ROOs for obtaining preferences (Das 2013). This could be problematic for businesses.

The challenge is to harmonize ROOs to ensure significant benefits to firms. The highest benefits are perceived to accrue first, to the giant business firms, second, to the large firms, and thirdly, to small and medium enterprises. Survey data suggested that four of the five East Asian countries, with at least 40% of the respondent firms, believed that the harmonization of ROOs would significantly benefit the firms. This is a formidable task and points to the need for a free trade agreement that is more efficient and consistent.

Promoting comprehensive coverage of agricultural trade was the third challenge associated with East Asian FTAs (Kawai and Wignaraja 2013). Many studies have indicated

that further liberalization of the agriculture sector is necessary to induce an increase in competition and improve the sector's productivity.

The fourth challenge is facilitating services-trade liberalization which is basically hampered due to several political (e.g. legal/constitutional barriers) and economic reasons. The fifth challenge is how to incorporate WTO-plus elements in the provisions of future Asian FTAs (Kawai and Wignaraja 2013) that will prove to be beneficial in view of the stalling of the Doha round.

Finally, the sixth challenge identified is the forging of a region-wide FTA. As mentioned in the previous section, a mega-trading bloc would likely generate larger gains amongst ASEAN members than engaging in several bilateral agreements. However, barriers related to political and economic considerations, i.e., political rivalry over FTA leadership (Kawai and Wignaraja 2013) could hamper the forging of such region-wide agreements.

The same political economy issue would bear on the negotiation of the RCEP. However, the Leaders' launch of the RCEP negotiation during the 21st ASEAN Summit in Phnom Penh in November 2012 affirmed ASEAN Centrality in regional economic cooperation and integration initiatives such as RCEP. ASEAN Centrality is further upheld by the ASEAN Framework for Regional Comprehensive Economic Partnership, which maintains "the centrality and proactive role of ASEAN as the primary driving force in its relations and cooperation with its external partners in a regional architecture that is open, transparent, and inclusive" (Article 1 section 15)<sup>7</sup>. Lim (2012) acknowledged the tediousness and complexity of the RCEP negotiations, considering the existence of multi-track sub-regional and bilateral FTAs in the region. The 16 Leaders have attempted to overcome this challenge by endorsing RCEP's Guiding Principles and Objectives for Negotiating<sup>8</sup>.

### **3. Regional Comprehensive Economic Partnership**

#### *Main objective and estimated impact of RCEP*

The main objective of the RCEP is to "attain a comprehensive and mutually beneficial economic partnership agreement that is expected to involve deeper engagement and

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<sup>7</sup> <http://www.asean.org/news/item/asean-framework-for-regional-comprehensive-economic-partnership>

<sup>8</sup> Lim, H. (2012), "The way forward for RCEP negotiations," East Asia Forum <http://www.eastasiaforum.org/2012/12/03/the-way-forward-for-rcep-negotiations/> (accessed October 3, 2013)

improvement over the existing ASEAN FTAs” (ERIA 2012). The RCEP could be seen as a compromise between CEPEA (ASEAN+3), which is led by Japan, and EAFTA (ASEAN+6), which is led by China. With this, the RCEP is expected to strengthen the “ASEAN Centrality”, thereby showing that the ASEAN, together with non-ASEAN member countries, are capable of bringing about economic growth through forging mega-bloc trade agreements (Das 2013).

If successfully negotiated, RCEP can lead to a harmonization of existing ASEAN FTAs (i.e. ASEAN+1 FTAs, CEPEA, EAFTA) wherein the same countries are involved. There is a presently a range of variations in provisions covering tariff lines, tariff reduction and elimination, customs-related issues like ROOs. RCEP may be a good instrument to address the “noodle bowl” effect of FTAs in East Asia. Lim (2012) indicates the direction that RCEP should take, namely, a simplified approach to ROOs, involving harmonization, co-equality of rules and the cumulation of value contents that aim to lower transaction and time costs.

The focus of the RCEP negotiations will be on the following eight key areas: trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement, and other issues<sup>9</sup>. The successful conclusion of RCEP negotiations will likely lead to produce a combined GDP of US\$26.2 trillion (32% of the world GDP), and encompass approximately 3.5 billion people or 48% of the world population (Das 2013).

**Figure 2** shows Itakura’s (2013)<sup>10</sup> estimate of the potential impact of various FTAs and more specifically, RCEP on member countries’ GDP. Itakura used an economy-wide simulation analysis based on a recursively dynamic CGE model to conduct policy simulations to capture the impacts of broader regional trade liberalization. The estimates showed that all of the FTAs of which the ASEAN member countries are participating tend to raise welfare. Among the FTA policy scenarios examined RCEP (ASEAN+6 FTA) leads to the largest positive impact on real GDP for most of the ASEAN member countries. This implies the need for liberalization reforms to attract more investments and generate higher volumes of international trade. Such measures as lowering barriers to trade, reducing or eliminating import tariffs, improving custom

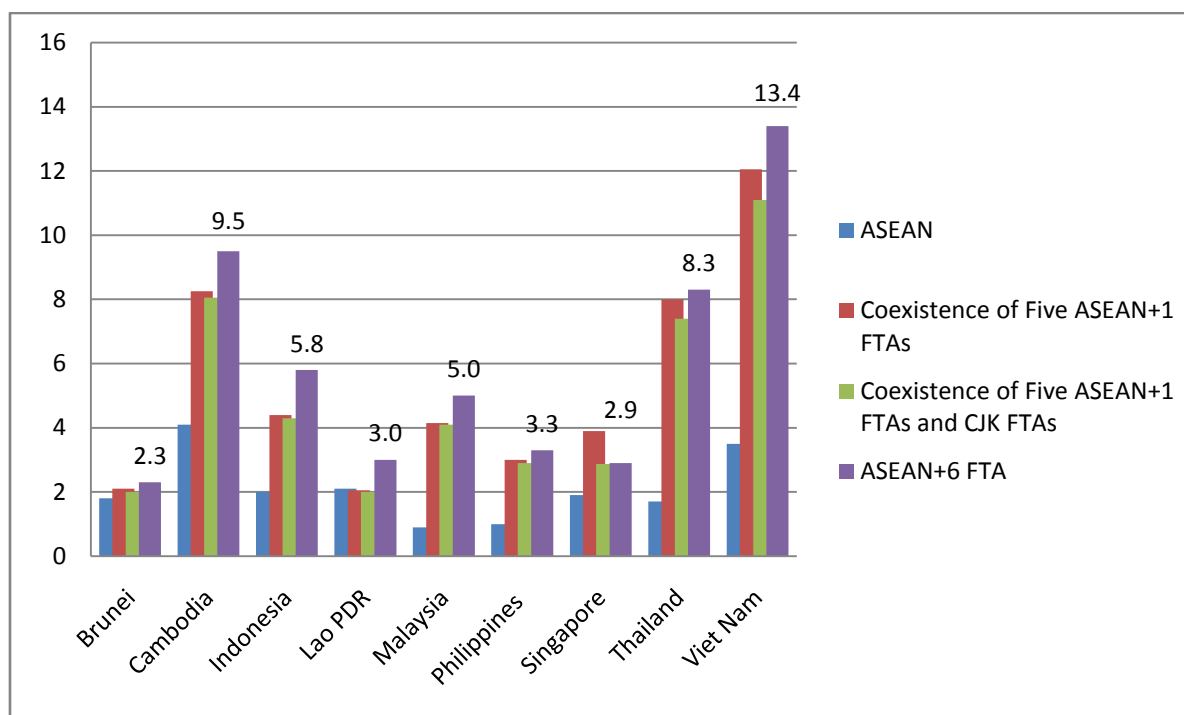
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<sup>9</sup> <http://www.asean.org/news/item/asean-framework-for-regional-comprehensive-economic-partnership>

<sup>10</sup>Itakura, K. (2023) “ Impact of Liberalization and Improved Connectivity and Facilitation in ASEAN for the ASEAN Economic Community,” ERIA Discussion Paper Series, January

administrative procedures, and improving transport and logistics form an important part of liberalization reforms.

**Figure 2. Potential Impact of RCEP measures on ASEAN Member Countries' GDP (percentage point, accumulated from 2011-2015)**



Source of Figure 2: Itakura (2013)

### *Key features of RCEP*

The following are some key features of RCEP<sup>11</sup>:

- “RCEP should be designed so as to develop and deepen an integrated production base in East Asia, and to be open to the rest of the world.”

To achieve this, several key items, that may not be present in existing FTAs, should be taken into account, namely: 1) consideration of the different levels of development of the member countries and provision of flexibility in adjustment towards agreed points; 2) an open

<sup>11</sup> “Regional Comprehensive Economic Partnership: A Statement by the ERIA Research Institute Network Meeting at Phnom Penh, October 2012; released on 22 November 2012. The interested reader can see the other features as listed in this document.

accession clause that allows members to participate either at the beginning of the agreement or at a later date, whenever they are ready, which also makes the RCEP open to external economic partners; 3) RCEP should encompass all existing ASEAN+1 FTAs and “not retreat on any provision for integration which already exists”; and 4) enhancement of three kinds of connectivity, namely, physical, institutional, and people-to-people connectivity.

- “RCEP should promote economic cooperation that has the character of ‘learning together’ so as to maintain momentum towards its overall objectives. RCEP should be designed so as to be user-friendly and business-friendly.”

By this, the members are expected to implement a simple tariff concession schedule that will be equally applied to all partner countries. Also, the “accumulation rule” will be applied such that member countries will be able to maximize the potential benefits from RCEP. The accumulation rule enables exporters and manufacturers to reduce the value of non-originating materials used in the production of a good, by taking into account inputs incorporated by FTA partner countries” (ACFTA 2009) <sup>12</sup>

- “Special and Differential treatment for CLMV (i.e. Cambodia, Lao PDR, Burma, Vietnam) countries should be based on a longer transition period instead of a lower threshold to avoid inefficiency and misallocation of scarce resources”;

Currently, there are FTAs that base their special treatment on the latter (that is, a lower threshold) which, as noted, leads to undesirable economic outcomes.

One of the main challenges in negotiating a free trade agreement is the harmonization of the provisions of all ASEAN+1 FTAs in the region. This includes overlapping ROOs and FTA preferences, among others.

The existing five ASEAN+1 and twenty three ratified bilateral FTAs vary greatly in terms of almost everything up for negotiation. One example is rules of origin (ROOs), which determine the country of origin of products and in turn their eligibility for preferential treatment in international trade. There are at least 22 different ROOs among ASEAN+1 FTAs, even after aggregating those that are similar but not the same. Only about 30% of tariff lines across the ASEAN+1 FTAs share common ROOs. With bilateral agreements — the Japan-India FTA for

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<sup>12</sup> <http://www.asean-cn.org/Item/892.aspx>

instance — there are 12 types of ROOs, seven of which are unique from the ASEAN+1 FTAs. The sheer number of ROOs — and their lack of commonality across FTAs — will make the task of harmonizing and consolidating them that much harder<sup>13</sup>.

The rationalization of the differing ROOs is deemed important as it will prevent the firms from incurring high transaction costs brought about by such differing ROOs. A study conducted by Medalla (2012) examines how much ROO convergence exists among these FTAs. **Table 2** below shows a summary of the ROO convergence incidence in the five ASEAN+1 FTAs.

**Table 2. Summary: ROO convergence incidence in ATIGA, AKFTA, ACFTA, and AANZFTA**

	# of HS lines (6-digit)	% Total	of Cumulative % share
<b><i>For all 5 FTAs</i></b>	181	3.5	3.5
Near convergence (with more liberal options in some cases)	137		
Convergent for 5 FTAs	44		
<b><i>For 4 FTAs</i></b>	2871	55.0	58.4
Near convergence (with more liberal options in some cases)	1407		
Convergent for 4 FTAs	1464		
<b><i>For 3 FTAs</i></b>	630	12.1	70.5
Near convergence (with more liberal options in some cases)	312		
Convergent for 3 FTAs	318		
<b><i>For 2 FTAs</i></b>	1027	19.7	90.1
Near convergence (with more liberal options in some cases)	728		
Convergent for 2 FTAs	299		
<b>Different ROOs across FTAs</b>	515	9.9	
<b>Total # of HS lines (6-digit)</b>	5224	100.0	

<sup>13</sup> This paragraph is from Menon, J. (2013) “The challenge facing Asia’s Regional Comprehensive Economic Partnership,” <http://www.eastasiaforum.org/2013/06/23/the-challenge-facing-asias-regional-comprehensive-economic-partnership/>

Source: Medalla (2012) “Toward deepening East Asian integration: How convergent are the rules of origin in the ASEAN+1 free trade agreements?,” Policy Notes No. 2012-20. Philippine Institute for Development Studies

As shown in **Table 2** above, the number of lines that are near convergence is 181 HS lines which only represent 3.5% of the total. However, it can be noted that majority (55%) of the total of HS lines are convergent among the 4 FTAs. This can be attributed to the different general rule (RVC-40) that the ACFTA has been using (Medalla 2012). Despite this, these are good indicators that ROO harmonization is possible and there is already a good foundation, i.e. harmonized ROOs, among the 4 FTAs. China and India are the only member countries that need to make adjustments in order to arrive into a single ROO template. Consequently, there needs to be a complementary action in member countries with regard to the dissemination of this information among stakeholders, especially the private sector. Differing ROOs will complicate trade and customs procedures and create negative impacts on investments and regional exchange.

Furthermore, Kawai and Wignaraja (2008) argued that the “successful formation of RCEP requires not only the completion of ASEAN +1 FTAs but also a series of agreements among the ‘plus’ economies, particularly among China, Japan, and South Korea.” This is notwithstanding the possible political rivalry over its leadership which has been evident in some FTAs in Asia.

Another complex area of negotiation is the on trade in goods, specifically, the different tariff classifications used by countries participating in the RCEP for their tariff concessions. Lim (2012) called attention to the problem of constructing straightforward schedules and of the same countries also using different schedules for their FTAs with different countries. In addition, tariff concessions from the same country differ depending on FTAs, and tariff elimination rates are different across ASEAN+1 FTAs. Lim (2012) advised the use of a common concession approach on certain goods.

#### **4. Key Challenges Facing the Philippines**

To date, the Philippines is involved in 15 FTAs<sup>14</sup> wherein seven have already been signed and in effect, while two are still under negotiation, and six have just been recently

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<sup>14</sup>Seven are signed and in effect: *ASEAN Free Trade Area*, *ASEAN-Australia and New Zealand Free Trade Agreement*, *ASEAN-India Comprehensive Economic Cooperation Agreement*, *ASEAN-Japan Comprehensive*

proposed. **Table 3** below shows the status of FTAs of ASEAN countries as of January 2013. According to Medalla et al. (2012), the value of trade between the Philippines and RCEP members amounts to US\$60 billion<sup>15</sup>. Upon conclusion of RCEP negotiations, there is expectation that the Philippines would be able to realize significant economic gains. However, the Philippines has to deal with several challenges that, if left unaddressed, could reduce those gains<sup>16</sup>.

**Table 3. FTA Status by Country, 2013**

COUNTRY	Proposed	Under Negotiation		Signed but not yet In Effect	Signed and In Effect	TOTAL
		Framework Agreement signed	Negotiations launched			
<b>Brunei Darussalam</b>	5	2	2	0	8	17
<b>Cambodia</b>	3	0	2	0	6	11
<b>Indonesia</b>	5	1	6	2	7	21
<b>Lao PDR</b>	3	0	2	0	8	13
<b>Malaysia</b>	6	1	6	1	12	26
<b>Myanmar</b>	3	1	2	0	6	12
<b>Philippines</b>	<b>6</b>	<b>0</b>	<b>2</b>	<b>0</b>	<b>7</b>	<b>15</b>
<b>Singapore</b>	5	1	10	3	18	37
<b>Thailand</b>	6	3	5	0	12	26
<b>Viet Nam</b>	4	1	5	1	7	18

Source: <http://aric.adb.org/fta-trends-by-country>

*Economic Partnership, ASEAN-Korea Comprehensive Economic Cooperation Agreement, ASEAN-People's Republic of China Comprehensive Economic Cooperation Agreement, Japan-Philippines Economic Partnership Agreement; Two are under negotiations: ASEAN-EU Free Trade Agreement and Regional Comprehensive Economic Partnership; and, six are recently proposed: ASEAN-Pakistan Free Trade Agreement, Comprehensive Economic Partnership for East Asia (CEPEA/ASEAN+6), East Asia Free Trade Area (ASEAN+3), Pakistan-Philippines Free Trade Agreement, Philippines-Taipei, China Economic Cooperation Agreement, United States-Philippines Free Trade Agreement; Source: <http://aric.adb.org/fta-country>*

<sup>15</sup> In 2011 figures

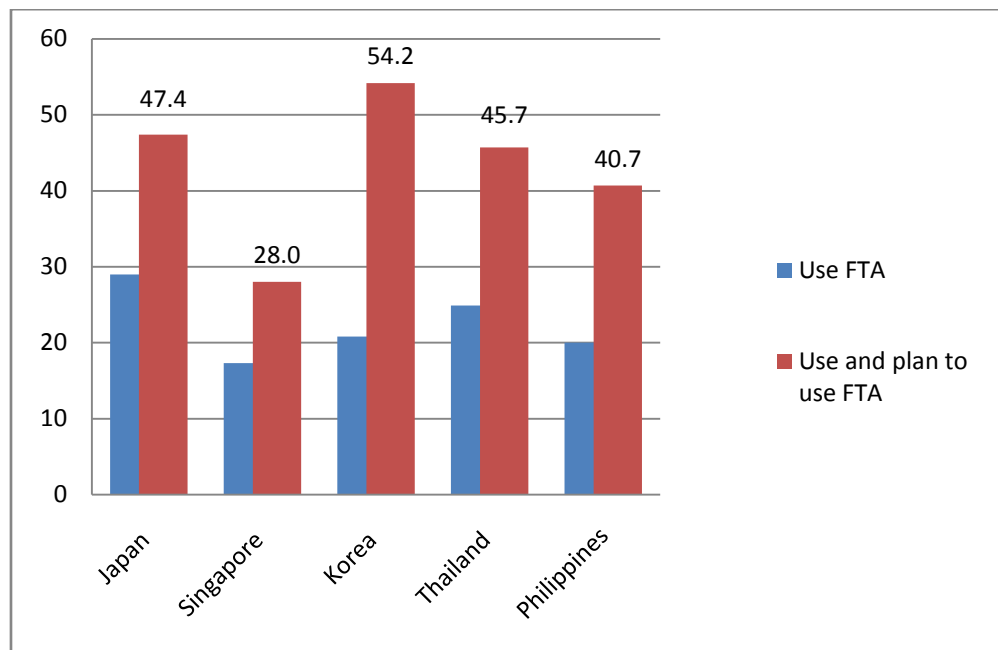
<sup>16</sup> There are other challenges but I focus on those that I think are necessary pre-requisites for successful negotiations of RCEP.



*Low utilization rate of free trade agreements*

The Philippines has low utilization of FTAs compared to those of other East Asian countries and even planned use of those agreements is relatively low. **Figure 3** shows the utilization of FTA preferences of some member countries as indicated by Kawai and Wignaraja (2009).

**Figure 3. Utilization of FTA Preferences**



Source: Kawai and Wignaraja (2009)

**Table 4** enumerates the reasons behind the low utilization rate of FTAs as perceived by firms in different countries.

**Table 4. Impediments to Using FTAs, by Number of Respondents**

Reasons for Impediments	Philippines
Lack of information	94 (70.1%)
Use of EPZ schemes/ITA	36 (26.9%)
Delays and administration cost <sup>b</sup>	41 (30.6%)
Small margin of preference	18 (13.4%)
Too many exclusions	20 (14.9%)
Arbitrary classification of product origin <sup>b</sup>	31 (23.1%)

NTMs in FTA partners	12 (9.0%)
Confidentiality of information required <sup>b</sup>	17 (12.7%)
<b>Number of respondents</b>	<b>134 (100.0%)</b>

Notes: (a) AFTA only; (b) Rules of origin requirement; (c) Multiple responses were allowed.  
EPZ = export process zone; ITA = Information Technology Agreement; NTM = non-tariff measure  
Source: Kawai and Wignaraja (2009)

The main impediment to utilization of FTAs among Philippine firms is the lack of information on FTAs. The low utilization rate of FTAs arising from a lack of information and understanding of how to take advantage of those FTAs has to be overcome. Other reasons cited in the survey were delays caused by cumbersome procedures, high administration cost, and arbitrary classification of product origin, which show the importance of the harmonization of rules of origin requirements among countries participating in a free trade agreement.

The survey results lead to the following measures to motivate greater utilization of FTAs: (i) more awareness training on concluded FTAs; (ii) more information on the implication of FTAs for business; (iii) upgrading of technical standards and quality; (iv) adoption of electronic data interchange to speed up and simplify procedures for ROO certification; and (v) financial support for upgrading technology and skills.

#### *Critical growth constraints*

With the private sector as main growth driver, it is important for policy makers to address barriers to investments. Policy makers have to address critical growth constraints that have been identified by recent studies. The constraints are as follows: (i) narrow fiscal space, (ii) inadequate infrastructure, (iii) weak investor confidence due to governance concerns, and (iv) market failures that have led to a small and narrow industrial and manufacturing base of the economy. These factors, which have constrained private-sector response to the opportunities provided by greater openness in the Philippines, will also constrain private sector utilization of FTAs or any regional free trade agreement such as RCEP. Inaction or failure to address these constraints will limit the realization of benefits arising from freer and more liberalized trade in goods and services.

The private sector plays a big role in realizing the benefits of any FTA, especially a comprehensive agreement such as RCEP. Its ability to utilize and take advantage of the opportunities offered by greater economic openness and integration will depend on how policy makers can effectively lift or eliminate such constraints. For instance, effective participation in regional production networks will depend on the presence and quality of necessary transport and logistics infrastructure. The envisaged ASEAN Economic Community will create a single and integrated production base and the country's ability to participate in regional production networks is accentuated by the presence of efficient infrastructure.

There is a large scope for improving infrastructure in the country. According to a report published by the World Economic Forum the country ranks 98<sup>th</sup> in terms of quality of overall infrastructure. **Table 5** shows the ranking of selected ASEAN countries in terms of quality of infrastructure. The serious problem on lack of investment in the sector is manifested in the ranking of the Philippines, which lags behind the other ASEAN member states as shown in the table below.

**Table 5. Ranking of Selected ASEAN Countries in Terms of Quality of Infrastructure**

Country	Quality of Overall Infrastructure	Quality of Roads	Quality of Port Infrastructure	Quality of Air Transport Infrastructure
<b>Singapore</b>	2	3	2	1
<b>Malaysia</b>	29	27	21	24
<b>Brunei Darussalam</b>	43	30	57	61
<b>Thailand</b>	49	39	56	33
<b>Cambodia</b>	72	66	69	75
<b>Indonesia</b>	92	90	104	89
<b>Philippines</b>	98	87	120	112
<b>Viet Nam</b>	119	120	113	94
Note: A total of 144 countries were ranked. Lao PDR and Myanmar were not included in the ranking. Source: The Global Competitiveness Report 2012–2013, World Economic Forum				

Development of the transport sector (air, land, and maritime) is one of the most important investment areas that the country needs to focus on especially in the context of greater economic openness and integration and more liberal trade in goods and services under RCEP. It is noted

that the transport sector is set to receive the largest chunk (57.93% or USD 34.79 billion) of the total investment target for the period 2011-2016 (NEDA 2012). However, there is still a need to attract large amounts of public and private investments in infrastructure in view of the relatively low level of infrastructure investments in the country. The rule of thumb in the ASEAN for infrastructure investments is that it should be at least 5% of GDP. Currently, Philippine infrastructure investments barely reach 3% of GDP.

There is a need for substantial investments in the infrastructure sector especially in the underdeveloped maritime sector as ports and shipping, which are integral to strategies to boost Philippine trade and critical to the objective of achieving more efficient connectivity in a country that has an archipelagic configuration. The government has resorted to the privatization of some ports but it has to improve both ports infrastructure and the regulatory framework governing ports and shipping. Previous reforms introduced to deregulate the maritime sector have to be supported by even more vigorous reforms. There is a need to examine the relevance of the cabotage policy, which is seen as a major barrier to competition in shipping and greater coast-wise and regional trade. The regulatory framework for the ports sector has to be reformed by separating the development and operation of ports from their regulation.

There is an inherent conflict of interest in having port development and ownership, on the one hand, and port regulation on the other, to reside in a single governmental body, the Philippine Ports Authority. In the maritime sector, there is a need to enforce transparent accounting and reporting standards for monitoring of the rate-setting exercise conducted by shipping companies<sup>17</sup>. It is equally critical to improve the enforcement of maritime safety rules and regulations to reduce the severity and frequency of maritime accidents (Llanto and others, 2007). These flaws in ports and maritime/shipping regulation erode efforts to stimulate private investments in the ports sector.

#### *Trade facilitation and customs administration*

There are other issues that have to be addressed in order to encourage greater private sector utilization of FTAs. Importers and exporters have to deal with complex and inefficient customs administrative processes and requirements. If private firms are to benefit from RCEP

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<sup>17</sup> It is claimed by certain quarters that shipping liners operate in a cartel-like manner.

the government has to remove impediments to trade facilitation and customs administration. The encouraging note based on a survey done by Aldaba and others (2012) is the firms' report that there have been improvements in trade facilitation, especially for SMEs. However, certain impediments such as inefficient procedures in government agencies relating to release of business certifications, permits and license still persist. Firms reported the need to improve trade facilitation through reforms in such areas as inspection and release of goods, customs valuation, and tariff classification. Institutional weaknesses in trade and customs transactions, more specifically weaknesses and corruption in the Bureau of Customs have to be resolutely addressed.

There is a great need to pursue reforms related to transparency, standardization and harmonization, and electronic processing of customs requirements. These are embedded features in customs modernization (e-customs) and the implementation of the national single window, which plays a key role in trade facilitation and risk management.

For the envisaged ASEAN Economic Community integration in 2015, one of the trade facilitation measures that the ASEAN needs to be compliant with is the implementation of ASEAN Single Window (ASW). This measure aims to simplify and unify access to customs services through electronic processing of requirements, connecting various government agencies performing trade transactions that will enable importers and exporters to transact using their computers and without need for face-to-face interaction with corrupt customs personnel.

Consequently, the putative ASEAN Economic Community needs to harmonize all trade transactions of member countries through the ASEAN Single Window. As of 2012, the Philippine National Single Window has been able to connect 26 of the 40 government agencies involved in trade and customs processes. This has allowed importers and exporters to electronically submit requests and payment for permits and licenses, as well as monitor their status online. However, it was reported that despite having been able to convert manual transactions to electronic, there remain unresolved certain issues within the Bureau of Customs itself, that is, between the NSW and the Value Added Service Providers (VASPs) who perform the tasks that the NSW will not assume once it becomes fully operational. There is natural resistance to an efficient NSW on the part of the VASPs, which have been contracted to do the trade facilitation for a fee. Moreover, full implementation of NSW is being slowed down by

problems with regard to the transfer of trade-related documents contained in the e2m customs, a local complement of the NSW in the Philippines.

It is conceded that there have been significant improvements in the automation of trade-related documents. However, more attention and decisive action should be given to full implementation of the NSW and critical reforms measures affecting export declaration and support documentations (packing list, bill of lading, manifest, airway bill, and invoice).

### *Dealing with services liberalization*

The RCEP will also focus on trade in services. Services liberalization is a difficult area of reforms in the Philippines. The lack of information on opportunities in the service sector, resistance by local professional groups and associations, e.g., engineering, constructors, and others, restrictions on the type of establishments and legal entities allowed, discrimination in favor of local services providers, and presence of discriminatory taxes on trade in services are very important barriers to service liberalization. Removal of these impediments will lead to better quality service through competition by various service providers in the region.

A survey of a few firms conducted by Aldaba et al. (2012) indicates several thorny issues in delivering services through local establishment: (i) need to engage a local agent (19 out of 27 firms); (ii) need to address discriminatory taxes on services delivered across border (16); and (iii) the need to meet restrictive local labor legislation in absence of mutual recognition arrangement for professional qualifications (11).

Aside from these issues, certain constitutional provisions pose a serious challenge to successful FTAs on services liberalization<sup>18</sup>. The economic provisions of the Constitution are seen as a strong deterrent or discouraging factor to foreign direct investments in the country. They cover restrictions in three areas of the economy: “the ownership of land, the operation and ownership of public utilities, and the exploitation of natural resources. The restrictions were in the form of limitations in the ownership of corporations by allowing a 60-40 equity proportion for Filipino and foreign capital, respectively. Foreign capital was restricted to a maximum 40% of the total ownership of corporations in these areas” (Sicat 2013, page 108).

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<sup>18</sup> Article XII, Section 10 of the Philippine Constitution provides that, “the Congress shall, upon recommendation of the economic and planning agency, when the national interest dictates, reserve to citizens of the Philippines or to corporations or associations at least sixty per centum of whose capital is owned by such citizens, or such higher percentage as Congress may prescribe, certain areas of investments.”

### *Investment incentives packages*

In the last two decades, the Philippines has liberalized FDI policies and formulated investment incentives measures to attract foreign investments. The grant of fiscal incentives is administered by different government bodies, e.g., Philippine Export Zone Authority, Board of Investments, Subic Bay Metropolitan Authority, and others under special laws. While the intention to attract FDIs is valid, the approach taken through investment incentives packages has some flaws. Aldaba (2007) described it as “a complex investment incentive system” (page 46). Worse, 80% of incentives given by the Board of Investments were found to be redundant (Reside 2006).

The complicated investment incentive system has created inefficiencies and overlapping promotion efforts. Thus, despite several investment incentives packages under administration by several government bodies, FDI inflows to the Philippines have remained relatively low and erratic<sup>19</sup>. There is need for reforms in fiscal incentives given to attract investments.

It is good that there are efforts under way to have a “coherent and integrated approach in the administration and monitoring of investment schemes” (Aldaba et al. 2012) through proposed legislation. The executive and legislative branches of government should coordinate on the enactment of a consistent and effective fiscal incentives program.

## **5. Conclusions and Recommendations**

The RCEP is deemed to be an important and logical step toward East Asian economic integration. It is too early to have a firm grasp of the expected benefits coming from this comprehensive agreement because the negotiations on key issues have just started, with the first round of negotiation done in on May 2013, and the second round in Brisbane, Australia on September 2013. The estimates done by Itakura show promising gains for the countries involved in the RCEP. It is noticeable that the estimated gain accruing to the Philippines is much smaller

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<sup>19</sup> The low FDI inflows can also largely be attributed to economic and political instability in the 90s. See Aldaba (2007).

than the benefits to be realized by other countries. It may be due to structural and institutional barriers constraining the growth and transformation of the Philippine economy. This paper's thesis is that the the Philippines should take key structural and institutional reforms in order to realize the potential benefits coming from participation in the RCEP, and as well to anticipate necessary adjustments to make in view of the changes in rules and processes governing trade, services, investments and other important areas.

This paper calls the attention of policymakers for necessary attention and action on a number of areas needing reforms: (a) low utilization of FTAs, (b) critical constraints to growth, (c) trade facilitation and customs administration, (d) services liberalization, and (e) investment incentives system.

On the low utilization of FTAs, the following will be important: (i) more awareness training on concluded FTAs; (ii) more information on the implication of FTAs for business; (iii) upgrading of technical standards and quality; (iv) adoption of electronic data interchange to speed up and simplify procedures for ROO certification; and (v) financial support for upgrading technology and skills.

On critical growth constraints, the paper highlighted the need to make substantial investments in infrastructure and to improve the institutional and regulatory frameworks of the ports and maritime sectors. The increase in infrastructure investments, notably in power, transport and logistics will lead to a reduction in the cost of doing business and facilitate trade. In line with this, the cabotage policy must be reviewed with the objective of providing more efficient connectivity between domestic and foreign markets. A liberalized maritime transport sector will contribute to the reduction of transaction costs, and to greater competition and accessibility of goods and services by the population.

On trade facilitation and customs administration, there is a great need to pursue reforms related to transparency, standardization and harmonization, and electronic processing of customs requirements, most especially in the implementation of an efficient National Single Window. It will be important to have a clear and unified understanding of trade-related guidelines and policies and a simplification of trade requirements (i.e. export documentation) among concerned government agencies involved in the National Single Window.



On services liberalization, the government needs to review all constitutional and legal barriers to investments and trade, in particular addressing issues on limitation of foreign equity i.e. the 60-40 rule in the ownership and operation of corporations.

There is also the need to reform existing investment incentives laws and institutional framework for the grant of fiscal incentives. The objective is to have a more coherent and consistent set of incentives that will be responsive to the new trade and investment regimes of a regionally integrated ASEAN.

Equally important is the need to have wider dissemination of information and public discourse on RCEP, especially to the private sector; distill facts from fiction; and determine the costs and benefits through further research on the RCEP's possible impact to the Philippine economy. Lastly, there must be public appreciation of the cost of non-participation in the RCEP and what the government should do for the economy to realize the potential benefits offered by such free trade agreements.

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